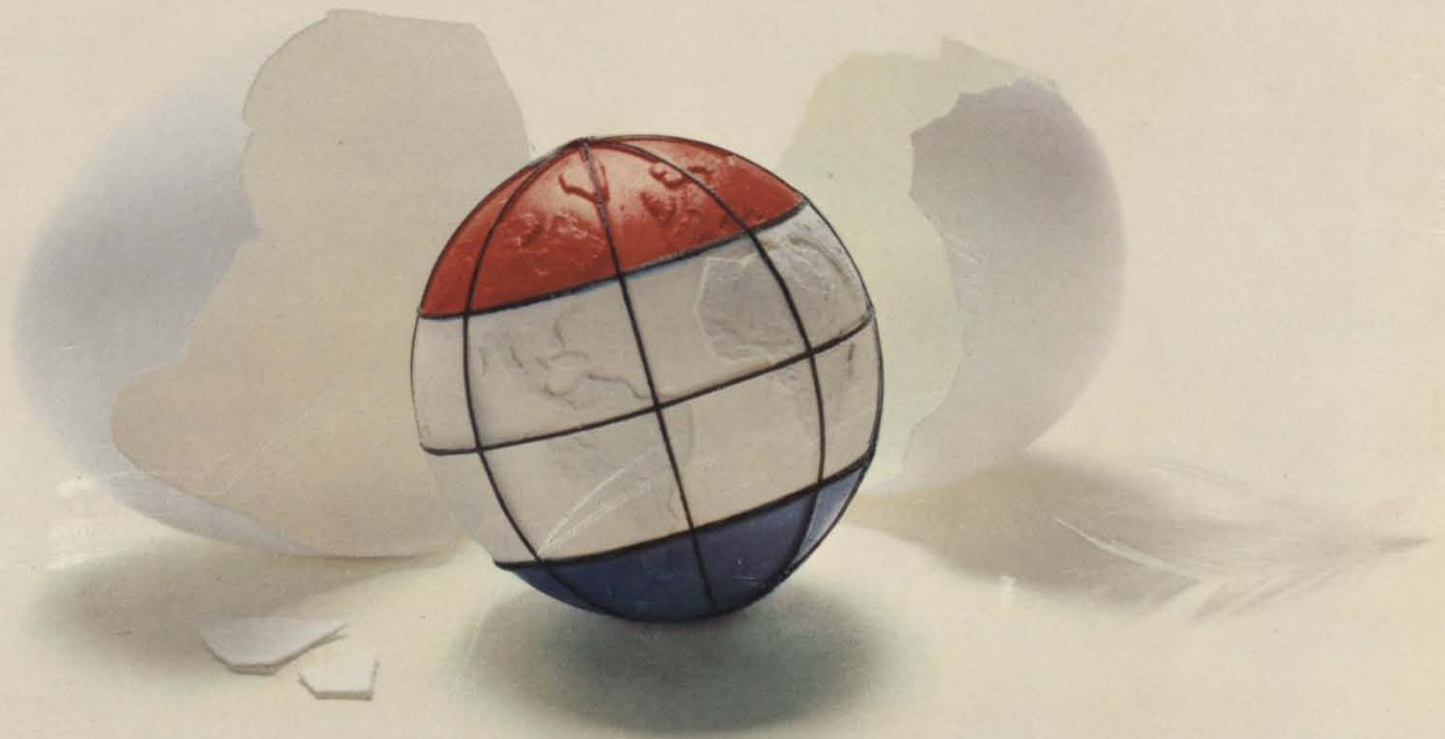


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PepsiCo, Inc. 1965 Annual Report

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Organization	INSIDE BACK COVER

PepsiCo, Inc. is a new world-wide consumer products and service company. The Company markets soft drinks through 925 franchised bottlers, operates more than 120 manufacturing plants, leases over 50,000 automotive vehicles, employs more than 19,000 persons and sells in excess of 100 food and beverage products, available to one billion consumers, in 107 countries of the world.

PepsiCo, Inc. Directors

Donald M. Kendall^{*†}

*President and Chief Executive Officer, PepsiCo, Inc.
and Chairman of the Executive Committee*

George C. Textor*

*President, Marine Midland Grace Trust
Company of New York*

Herman W. Lay^{*†}

*Chairman of the Board, PepsiCo, Inc.
and Chairman of the Finance Committee*

Harry E. Gould*

*Chairman of the Board, Universal American Corporation,
diversified manufacturer of industrial products*

Herman A. Schaefer[†]

Vice President, Finance, PepsiCo, Inc.

Charles Allen, Jr.[†]

Senior Partner, Allen & Company, Investment Bankers

Thomas Elmezzi*

*Executive Vice President, PepsiCo, Inc. and
Chairman of the Board of Empire State Sugar Company, Inc.*

Peter K. Warren

President, PepsiCo International

Fladger F. Tannery*

*Executive Vice President, PepsiCo, Inc.
and Chairman of the Board, PepsiCo International*

Dr. Louis A. Rezzonico*

Personal Investments

John D. Williamson

Senior Vice President, Frito-Lay, Inc.

Herbert L. Barnett*

Chairman of the Board, Pepsi-Cola Company

H. L. Meckler[†]

*Vice President, PepsiCo, Inc. and
Chairman of the Board and President,
Lease Plan International*

Robert H. Stewart III[†]

Chairman of the Board, First National Bank in Dallas

James B. Somerall

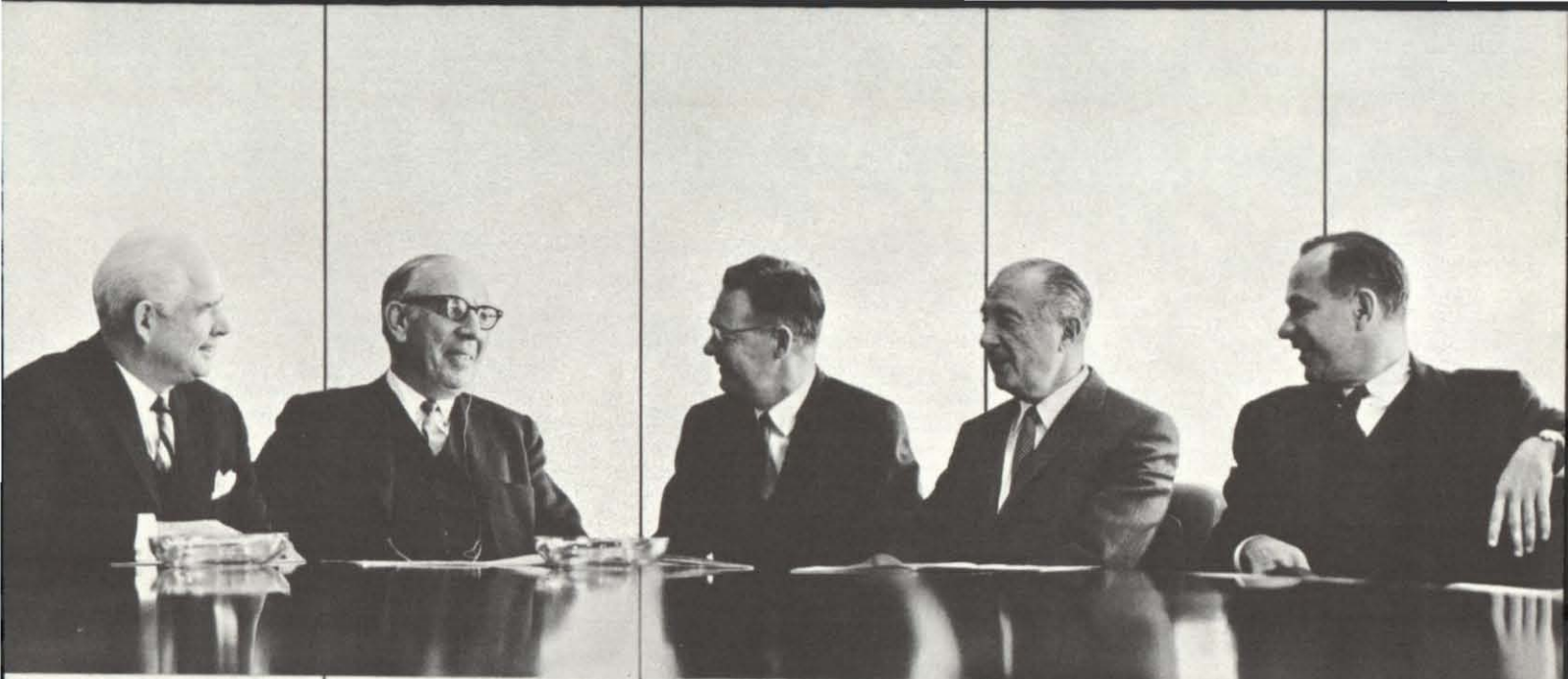
President, Pepsi-Cola Company

William B. Oliver*

President, Frito-Lay, Inc.

^{*}Member of the Executive Committee

[†]Member of the Finance Committee



To Our Shareholders:

For PepsiCo, Inc., a new world-wide consumer products and service company, 1965 was a successful and historic year.

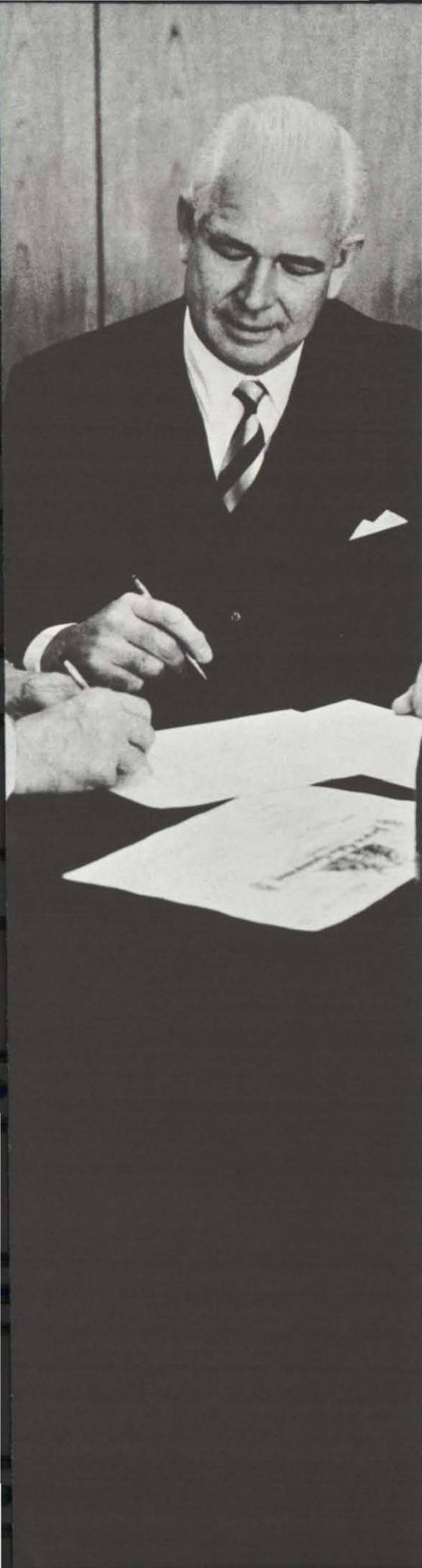
Sales and earnings reached record levels. Net sales for the year ended December 31, 1965 were \$509,950,282, an increase of 12% over \$455,811,574 for 1964. Net earnings were \$33,199,301 compared with \$28,305,325 in 1964, which on a per share basis is \$3.21 compared with \$2.76, an increase of 16% per share based on shares outstanding at the end of the respective years.

PepsiCo is truly a new company in the structure of its organization and in the scope of its operations. The idea of newness and creation is conveyed on the front cover of this report. We will try on the pages that follow to give shareholders, employees, bottlers, distributors, customers, suppliers and other interested parties an understanding of the various elements which make PepsiCo a world-wide consumer products and service company. Each of the five major divisions is described in some detail because of our belief that this first annual report following the recent reorganizations of Pepsi-Cola Company, Frito-Lay, Inc., and Lease Plan International Corp. will be of special interest.

We are pleased with the overall results for 1965, in spite of two factors which had an adverse effect on 1965 earnings, and have been mentioned previously in quarterly reports to shareholders and in the press. We refer to the abnormally high cost of potatoes during the first seven months of the year and the work stoppage affecting Pepsi-Cola in Long Island City, Bronx and Brooklyn, N. Y., plants for the last seven months of the year. Potato costs were at normal levels in the last five months of 1965, and while we have no way to foretell the effect of weather and other growing conditions on this raw vegetable crop, indications are that potato costs will be more normal in 1966.

The work stoppage referred to above ended in February, 1966. While it is impossible to pinpoint the strike's full cost in either 1965 or 1966, it had a considerable effect on sales and earnings in 1965 and will continue to be felt in 1966, both because of the continuation of the work stoppage well into the first quarter and the costs related to the





market re-development job that must be done. Every effort is being made to mitigate the effects on future sales and earnings through an aggressive program of product re-vitalization in the New York City market. We are confident that the strong consumer acceptance long enjoyed by Pepsi-Cola in this market will produce constantly increasing sales now that the product is again available. In addition, DIET PEPSI-COLA and MOUNTAIN DEW are being made available in New York City for the first time.

You will find interesting and helpful the information in this report regarding the newest member of the PepsiCo family, Lease Plan International Corp. H. L. Meckler, who continues as President and Chief Executive Officer of Lease Plan, is now a member of both the Board of Directors and the Finance Committee, and a Vice President of PepsiCo. We are optimistic in viewing the growth potential of Lease Plan and the new direction given to the Company by its entry into the service industry both in the U. S. and overseas.

There has been considerable delay in the final completion of the new beet and cane sugar refinery in Central New York State. Your attention is directed to further information in the Sugar Division Report.

PepsiCo, Inc., engaged in additional financing for expansion of the sale of its food products into overseas markets through the issuance, by a wholly-owned subsidiary, of \$30 million of convertible debentures, which were offered to the public outside the United States on March 1, 1966. The entire issue was immediately sold. By selling the debentures only outside the U. S., the Company supported the President's voluntary balance-of-payments program.

We are pleased to introduce our newly-constituted Board of Directors in this Report. This group of men has an unusually broad basis of business experience, and a diversity of management talent.

On the following pages you will also meet the heads of the principal operating divisions. We are fortunate to have such an outstanding group of experienced men, who have spent immeasurable time and energy building strong and aggressive management teams in their respective divisions.

We appreciate the enthusiastic loyalty and enterprise of all PepsiCo employees. Our success in introducing the recent far-reaching changes in the Company was possible only with this support.

We are confident that the Company will continue to grow in both sales and earnings in 1966.

Very truly yours,

Herman W. Lay
Chairman of the Board

Donald M. Kendall
President

Pepsi-Cola



Pepsi-Cola Company History

The first Pepsi-Cola product was created in an old-fashioned drug store in New Bern, North Carolina about 1896 by pharmacist Caleb "Doc" Bradham. In 1903 Bradham officially registered the name "Pepsi-Cola" as a trademark, formed his own company and gradually increased distribution.

Pepsi-Cola's first advertising called the product simply "delicious," and its popularity gradually spread. By 1910 Pepsi-Cola bottling franchises had been issued to more than 280 bottlers under the same type of independent



franchise system in use today. Under this system, local bottlers in their exclusive marketing areas buy concentrate and syrup from the company, and under exacting standards produce the finished Pepsi-Cola product and market it locally.

Pepsi-Cola introduced a new 12-ounce bottle in 1933 in an industry where the standard size was 6½ ounces, and later promoted the product with the famous "Twice As Much For A Nickel, Too" slogan. This decision fostered a classic marketing revolution for the company since Pepsi-Cola enjoyed tremendous growth from that moment on.

A new management team of sales and marketing experts took over the company in 1949, and between 1950

and 1959 they engineered the most sensational business climb in soft drink history. In that decade world-wide sales and earnings boomed.

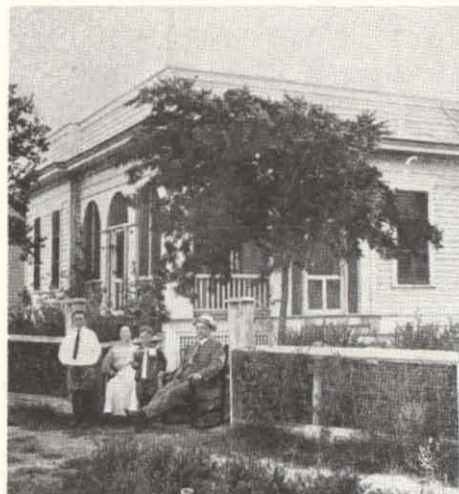
In 1963 Donald M. Kendall became president and chief executive officer. Under Mr. Kendall's leadership, the company achieved the highest sales and earnings in its history in 1964.

Over the years, Pepsi-Cola Company's advertising progressed through various stages of development: "The Big One," "The Light Refreshment," "Be Sociable," "Say Pepsi, Please," "Now It's Pepsi, For Those Who Think Young," and finally the current campaign, "Come Alive! You're In The Pepsi Generation."





Fritos & Lay's



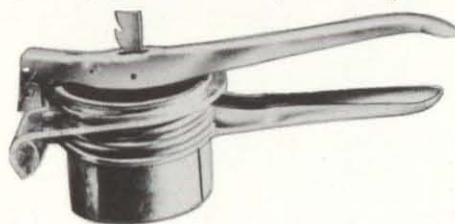
Frito-Lay History

Frito-Lay was formed in 1961 just twenty-nine years after the founding of its component companies, The Frito Company of Dallas and H. W. Lay & Company of Atlanta. Both companies were started in 1932 and the circumstances surrounding their beginnings are similar. In that year Elmer Doolin, a young Texan, began production of FRITOS corn chips, a product which has become one of the most popular in the snack food industry.



In the same year Herman W. Lay began to build his own organization of potato chip and snack food distribution in Nashville and later in Atlanta.

H. W. Lay & Company became one of the largest snack and convenience food companies in the Southeast with its primary product LAY's potato chips.



In 1945 The Frito Company granted H. W. Lay & Company an exclusive franchise to manufacture and distribute FRITOS corn chips in the Southeast. Thus began a close business affiliation which eventually resulted in the merger of the two companies.

Under progressive leadership, The Frito Company grew and prospered during the 1950's. Distribution was expanded throughout most of the U.S. by the granting of licenses for the marketing of FRITOS corn chips.

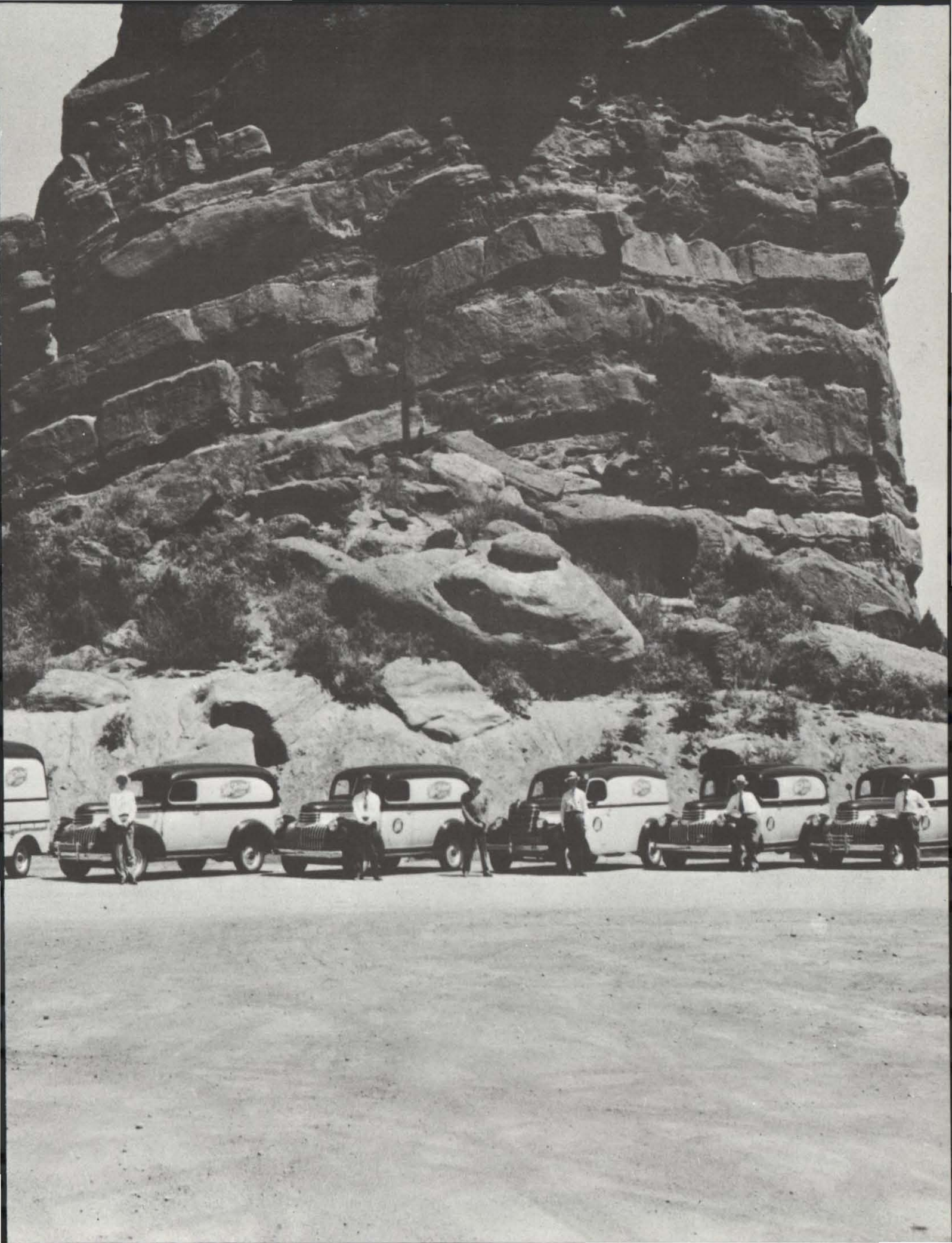
At the same time, H. W. Lay & Company expanded its operations outside the southeastern United States through the development of an experienced and

hard-hitting organization. Early in 1961 facilities for the national distribution of pretzels were acquired.

When Frito-Lay, Inc. was formed in 1961, the newly-formed company had manufacturing plants, sales routes and thousands of employees from coast to coast. The company stock was listed on the New York Stock Exchange in 1964.

In addition to a complete line of snack and convenience foods, the company diversified into the canned meat and Mexican specialty products area, and other convenience food lines such as olives, cherries and similar products.





PepsiCo, Inc. Financial Highlights

Net Sales in 1965 were a record \$509,950,282, an increase of 12% over \$455,811,574 in 1964.

Net Income for 1965 was a record \$33,199,301, compared with \$28,305,325 last year.

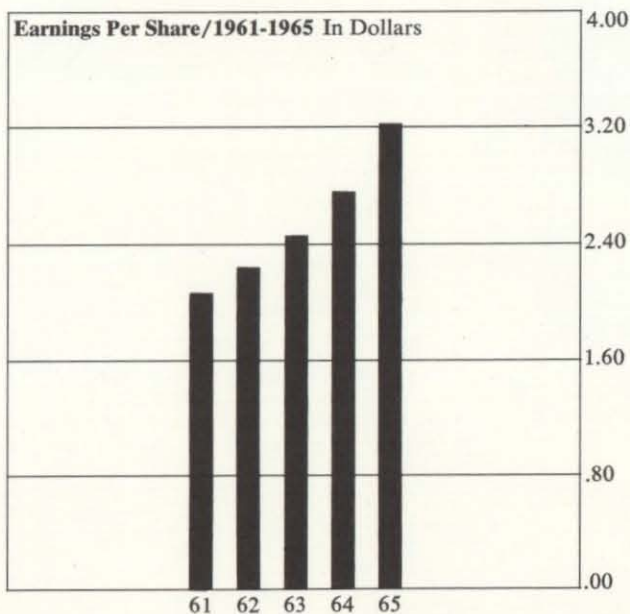
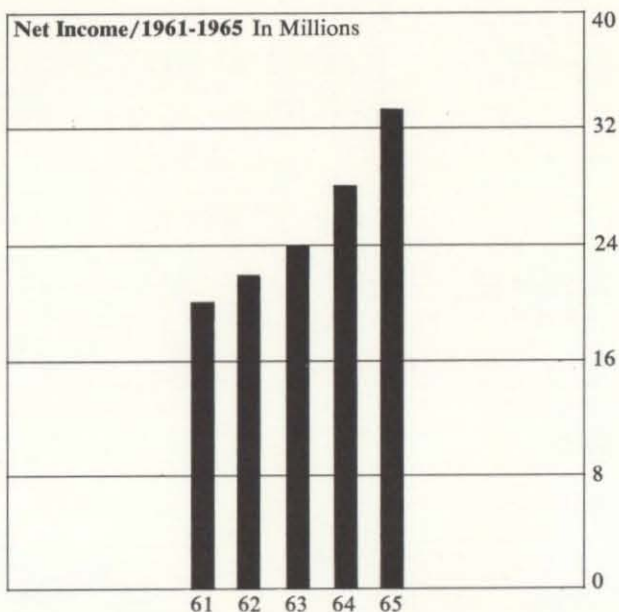
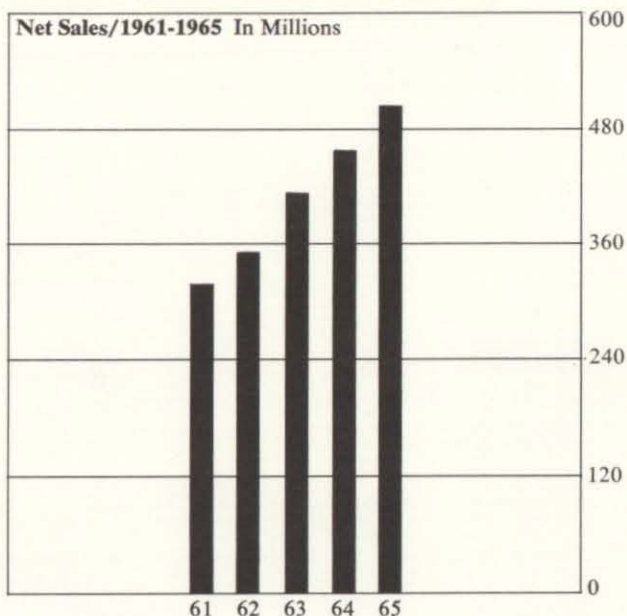
Earnings per share were \$3.21, rising 16% per share from \$2.76 in 1964.

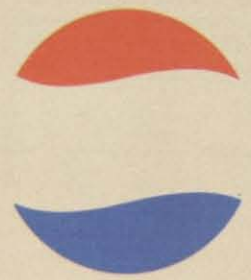
PepsiCo's sales and earnings for both years combine the results of operations of Pepsi-Cola Company and Frito-Lay, Inc., and include the net income of Lease Plan International Corp. Shares outstanding at the end of the respective years were 10,330,990 shares in 1965 and 10,237,313 shares in 1964, giving effect to the adjustment for the poolings of interests of PepsiCo, Inc. with Frito-Lay, Inc. and Lease Plan International Corp. (See Note #1 of the Financial Notes to the PepsiCo, Inc. Statements for the basis of consolidation.)

Dividends paid on common stock in 1965 were \$1.60 per share, at the rate of 40¢ quarterly per share, compared with \$1.40 in 1964, at the rate of 35¢ quarterly per share.

Total Property, Plant and Equipment increased by \$30,607,059, to \$185,308,027 in 1965 from \$154,700,968 a year ago. Depreciation and amortization was \$13,770,000 and \$11,560,000 for the two years respectively.

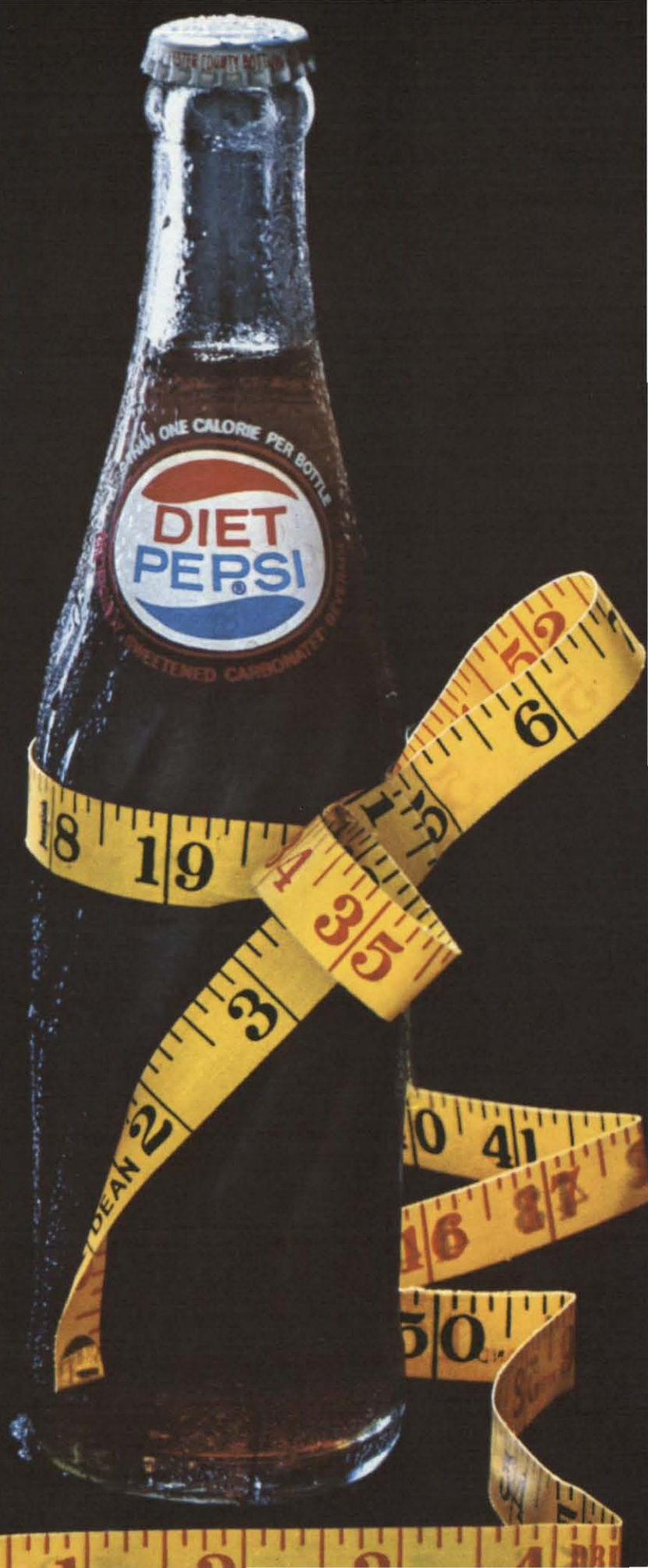
Shareholders Equity increased to \$170,448,374 at the end of 1965, compared with \$149,966,735 at the end of 1964, or from \$14.65 book value per share to \$16.50 book value per share.





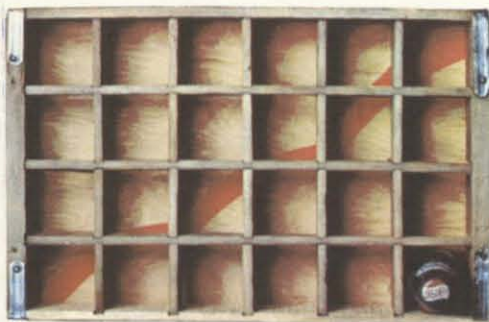
James B. Somerall, *President*





Pepsi-Cola Division

Sales of the Pepsi-Cola Division reached the highest point in its history in 1965. This division reoriented its activities based on a brand management concept which was determined to be the most effective way to expand the business of its several major brand name products.



Background — PepsiCo, through the Pepsi-Cola Division, which is responsible for the marketing of all beverage products in the U. S., is a major producer of concentrates and syrups which are sold for use in the bottling and distribution of PEPSI-COLA, DIET PEPSI-COLA, TEEM, SUGAR-FREE TEEM, MOUNTAIN DEW, PATIO flavor line, and various other beverage trademarks. These products are marketed to consumers through approximately 500

independent, franchised bottlers, and 24 Company-owned bottling plants throughout the U. S.

Products — Of particular importance to the Division is the strength of the product, PEPSI-COLA, which achieved an encouraging growth pattern for the year. A major factor in its improvement was the strong syrup incentive program for the sale of syrups at soda fountains which was instituted in 1964.

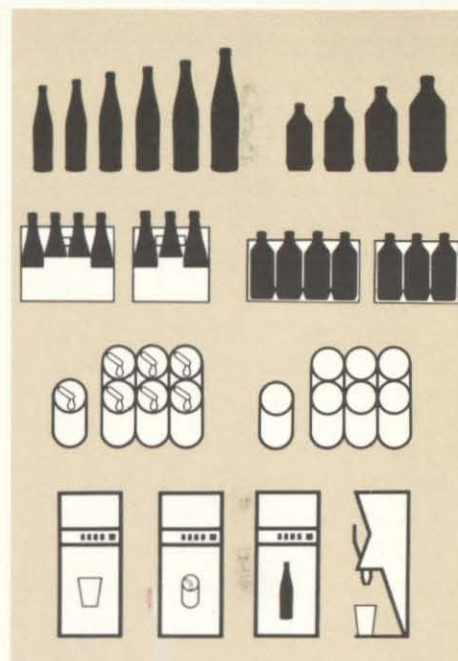
DIET PEPSI-COLA sales also showed strong advances during the year, in part due to the product's successful penetration of the fountain syrup market. DIET PEPSI is available to 99% of the U. S. population. The product fractionally increased its share of the total diet soft drink market which, as a whole, tended to level off during the last half of the year.

TEEM and SUGAR-FREE TEEM, the Division's lemon-lime products, declined slightly as part of a declining lemon-lime market generally.

PATIO flavor line sales were up for the year, due mainly to the impact of the strengthened syrup program, and expanded distribution into new markets.

Convenience Packaging — The two convenience packages—cans and “one-way” bottles—are the fastest growing packages in the soft drink industry. Pepsi-Cola's convenience package activities increased at a greater rate than that for the industry generally.

The sales of canned Pepsi-Cola products increased substantially over last year. In 1965 the number of bottlers distributing cans increased to the extent that this type of package was available to more than three-fourths of the U. S. population.

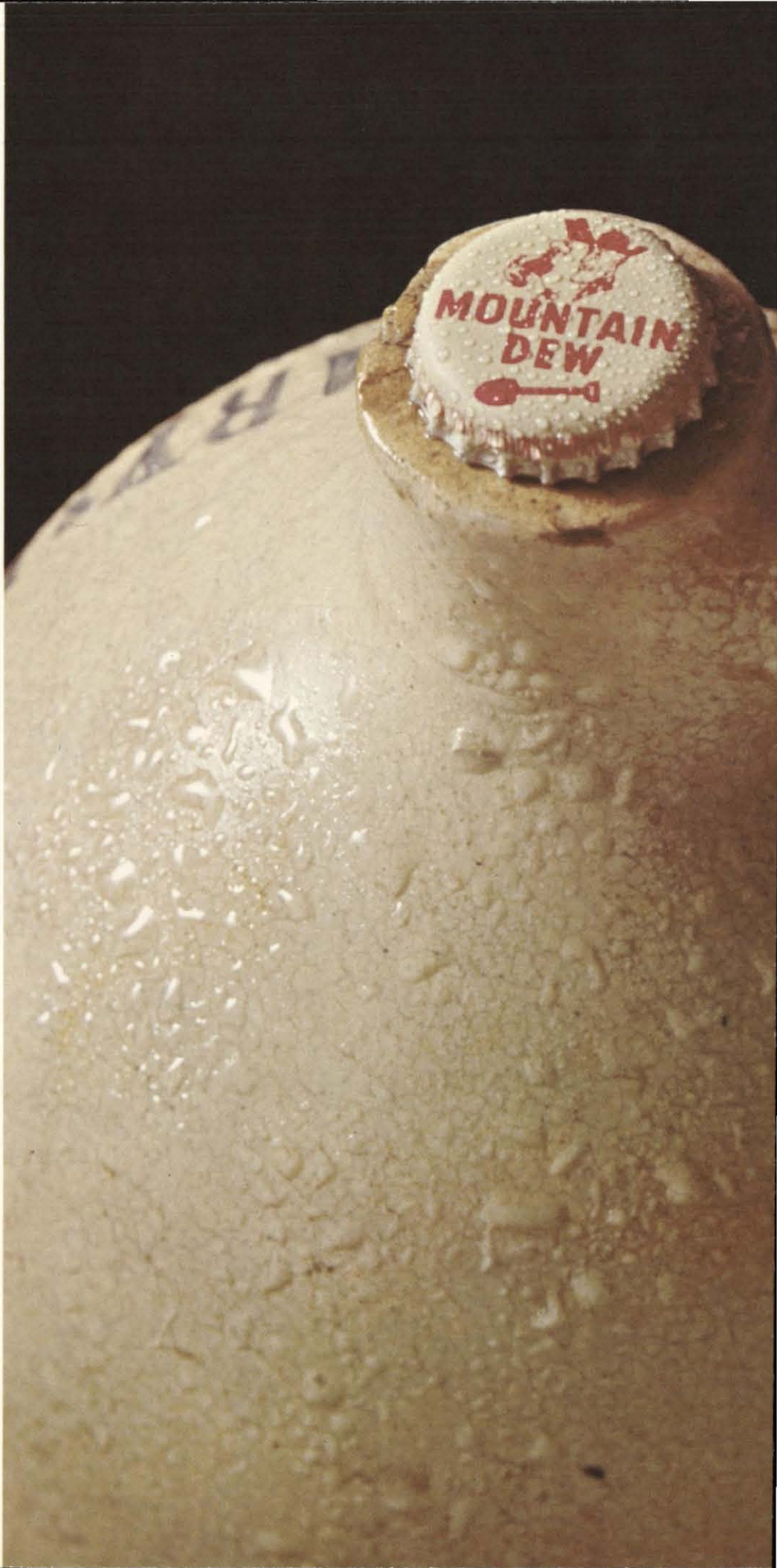


The Division is experimenting with new and improved opening devices and working with glass and can suppliers to develop even more effective packaging.

Vending — Through equipment incentive programs, Pepsi-Cola bottlers placed an unusually large number of vending machines on location throughout the country. The Division also introduced an attractive new display case, named Vis-A-Cooler, which is a potentially high volume marketing tool.

New Products—The Division's new soft drink MOUNTAIN DEW continues to grow at an exceptional rate with continuing success in both longer established and newer markets. By the end of 1965, the product was sold in markets serving over three-fourths of the U. S. population. With aggressive marketing programs in 1966, and the entry into more new markets MOUNTAIN DEW's growth is expected to continue.

A new chocolate beverage has been developed. This improved chocolate drink product is now possible through the use of hydrostatic sterilizing equipment, which provides product uniformity and longer shelf life. The chocolate drink is expected to be on the market in several major metropolitan areas by the summer of 1966.



Fountain Sales—Syrup equipment programs for the improvement of Pepsi-Cola's fountain business were well accepted by bottlers during the year. Nearly four-fifths of the Division's syrup products will be prepared by local bottlers through equipment installed during the past year. The fountain equipment incentive program was responsible for the substantial increase of fountain equipment purchases in 1965 over the previous year. As a result, bottlers placed equipment which accounted for impressive fountain sales increases.

National Sales—A program for expanding soft drink sales to large national or regional accounts, in support of the bottlers' marketing operations, was successful during the year. Under this program, sales to gasoline station outlets, chain restaurant and variety stores, the U. S. Government, and grocery chains increased considerably.

Technical Services—The objective of high standards of quality control was enhanced during the year by the placing into full service of four new traveling laboratory units, equipped with the most modern testing apparatus available. These "traveling labs" will be deployed throughout the country to support the bottlers quality control programs on a regular basis.





Sunken pleasure.
Discovered by the Pepsi generation.

The lowdown?
Great taste: Bold and ocean-cold.

With the lift to pick you up
when you're feeling down.

You don't find refreshment like this just anywhere.
Take a Pepsi out to see.



Advertising—The “Come Alive! You’re In The Pepsi Generation” advertising campaign reached a new peak in 1965 with an increased consumer awareness and recall ability. A highlight of the Division’s television advertising was the widespread use of 235 local area television plans designed to serve natural marketing regions.

Another effective advertising concept was the “dual approach” used to promote PEPSI-COLA and DIET PEPSI-COLA together. A major result was the quick establishment of the new product, DIET PEPSI, without the usual heavy introductory expenses.

In November Pepsi-Cola Division participated in the television spectacular, “The Incredible World of

James Bond.” This highly rated telecast also marked the national advertising debut for MOUNTAIN DEW.

The Miss America Pageant, traditionally the most widely viewed television show of the year, was again co-sponsored by the Company.

Bottlers’ participation in the cooperative advertising and promotion activities reached new high levels during the year. Current orders from bottlers for new marketing materials indicate strong preparation for an intensive 1966 marketing program designed to broaden product display and advertising space in 40,000 key food store outlets.

Sales Training—Sales training activities included more than 65 training schools attended by 3,600 route salesmen, sales supervisors, and sales managers. In addition, training schools for field personnel were held in each of the marketing regions in anticipation of the 1966 national food store marketing program.





Promotions—The \$2 million Pepsi-Cola Shopping Spree successfully ran for its second year and increased its effectiveness as a sales stimulant. The promotion received widespread favorable publicity throughout the country. During 1966 an expanded version of the Shopping Spree will incorporate the distribution by bottlers of 30 million “10c-off” coupons. This will be followed in late summer by an additional national promotion.

Public Relations — The Company’s exhibit at the New York World’s Fair, “It’s A Small World—A Salute to UNICEF,” designed by Walt Disney, concluded its final year with the highest paid attendance of any attraction at the Fair—and a two-year total attendance of more than 10 million visitors.

Pepsi-Cola's public relations activities also included the sponsorship of state and national Miss America pageants; participation in youth and sports activities with the U. S. Jaycees and other organizations; and other consumer oriented programs.

Miss Joan Crawford, Academy Award motion picture star and member of the Pepsi-Cola and Frito-Lay boards of directors, was active in public relations activities for the Company during 1965.

Manufacturing—Concentrate manufacturing capacity was increased by the completion of a new plant in the Dallas-Fort Worth area. This facility is a modern, fully automated manufacturing plant, which has the capability for expansion to cover canning and other operations in the future.

Seventeen new bottling plants were opened by franchised bottlers throughout the United States during the year. An additional 25 plants were expanded or had new equipment installed, in order to increase productive capacity.

Company-Owned Plants—PepsiCo, through its subsidiary Pepsi-Cola Metropolitan Bottling Company, Inc. owns or operates 24 bottling plants in the U. S. During 1965 the Company acquired certain additional bottling franchises, including Westchester County, N. Y., Allentown, Pa., and Houston, Texas. In February, 1966, the Company announced that negotiations were being conducted for the acquisition of Pepsi-Cola Bottling Company of Long Island, Inc.





William B. Oliver, *President*

Frito-Lay Division

Frito-Lay Division had an excellent year in sales of both its snack and other convenience foods. Volumes grew through intensified distribution and selling activities which resulted in increased consumer acceptance of the Division's broadened product line, and the continued growth of snack or convenience foods markets.

Background — Frito-Lay is a major producer and marketer of snack and convenience food products in the United States and Canada. Among the many products sold are FRITOS corn chips, LAY'S and RUFFLES potato chips, CHEE-TOS cheese flavored puffs, ROLD GOLD pretzels, fresh nut meats and AUSTEX and FRITOS brands canned foods, including chili, tamales, barbecued beef and party dips, among others. The Nu-Way division makes food flavorings and individually packaged servings of jams, catsup and other food toppings. The Belle Products division processes olives, maraschino cherries, cocktail onions and peppers.

Food Products — LAY'S potato chips reached national distribution by the end of the year (except for the greater Chicago area markets). The first

national network television commercials for this product were shown in November. LAY'S and RUFFLES brands are the first potato chips in this country with virtual national distribution.

FRITOS corn chips continued to be a popular, national consumer product, and maintained a strong market position during the year.

DORITOS, a tortilla chip, was successfully introduced in several of the Division's marketing areas and has experienced strong initial and repeat business. Distribution of this product will be expanded as rapidly as additional equipment is installed.

LAY'S dry roasted peanuts also made promising strides during the year. As a follow-up to the successful 10c package, a grocery-size 39c package is being test marketed on a limited basis in anticipation of its possible entry during 1966.

RUFFLES potato chips, ROLD GOLD pretzels, CHEE-TOS cheese flavored puffs, and FRITOS bean dip substantially

increased in sales during the year and FRITOS dip mixes—Kosher Dill and Horseradish—reached national distribution.

Facilities — The Frito-Lay Division operates 46 strategically located manufacturing and processing plants in the U. S., and one plant in Canada. Twenty-eight of the U. S. plants are owned, and 18 are held under leases.

Employee Relations — Employee efficiency and morale were maintained at a high level. Labor contracts were negotiated successfully with no major work stoppages.

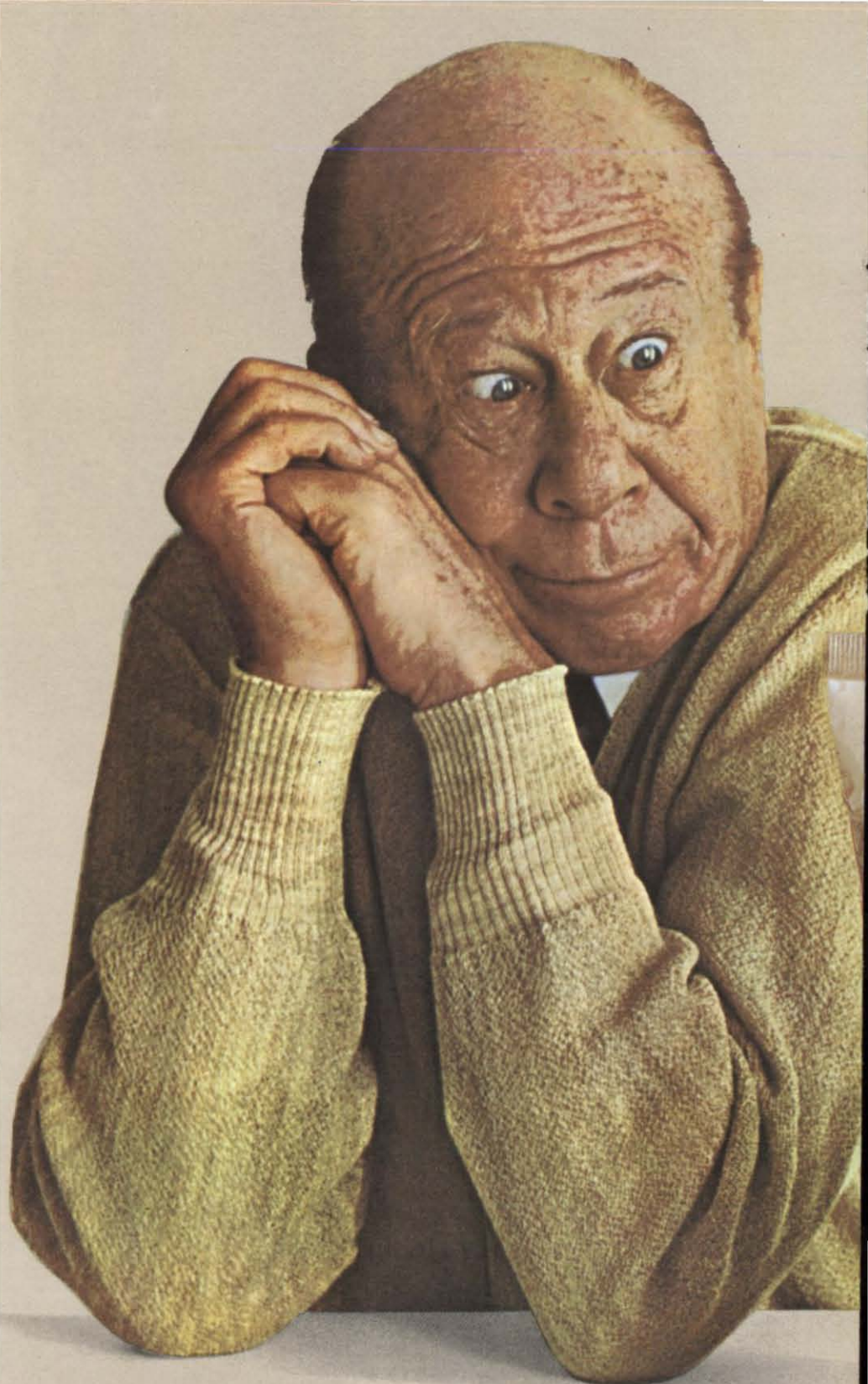
An intensive management development and training program was carried out for regional sales and production managers in training sessions held throughout the country.





Expanding Markets—The snack or convenience food segment of the food industry has become increasingly prominent in the last few years. Consumption of convenience foods in the last six years has grown much faster than that of foods generally. This growth rate can be attributed in part to an expanding youth market, increased leisure time, television, self-service supermarkets, more women at work and increased home entertaining.

Distribution—Frito-Lay snack products are transported by large tractor-trailers to 1,000 major distribution points. Multi-weekly deliveries to retail outlets are made by more than 3,200 driver-salesmen and independent distributors covering established routes. The distribution set-up is extremely important in keeping food products fresh and retailers' stocks and displays properly supplied. Our other convenience foods are sold through food brokers for distribution directly to wholesale grocers, institutional grocers and chain warehouses.



Advertising And Promotion — Demand for the Division's snack products was successfully stimulated by several national advertising campaigns and regional promotions. LAY's potato chips made great strides through the Bert Lahr campaign with the theme "I'll Bet You Can't Eat Just One."

FRITOS corn chips were marketed under the "Munch A Bunch of Fritos" slogan. RUFFLES potato chips, with "R-R-Ruffles have R-r-ridges," and ROLD GOLD pretzels benefited from bright, appealing national advertising programs.

For the fourth year the popular, national flower seed promotion was used as a sales stimulant for FRITOS corn chips.

Research — Progressive research in new product development and processing and packaging improvement continued to be a major effort during the year. Frito-Lay fully recognizes the essential contribution that a strong research program will make to its future, and the overall growth of the snack food industry.

From the experimental farm and genetic research programs came the development of a new, high quality potato, named Monona. The potato was developed after intensive cross breeding and test-growing designed to develop a quality potato for chip production. Quantity growing of the new variety will begin this year, but it will be several years before production reaches commercial levels.

Through further research a corn variety was discovered which improves product taste and offers further economy in corn chip production.

In the equipment field the Division is participating in a research project for the design of a new micro-wave oven, which is expected to improve the quality of potato chips.





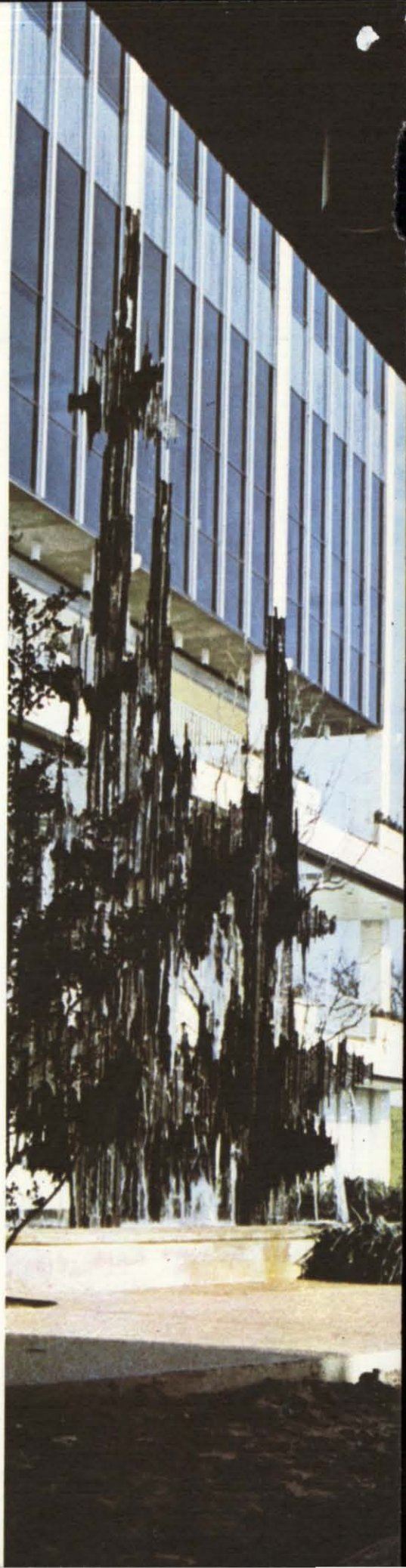
New Headquarters—The Division's headquarter's offices were moved into the modern, 17-story Frito-Lay Tower in Exchange Park, Dallas, in December, when the official opening of the building was held. Miss Joan Crawford, newly appointed Frito-Lay director, and a host of Company, business and community leaders joined in the ceremonies.

Manufacturing—As part of a continuing long-range program of facilities improvement, the Division in 1965 invested approximately \$6 million in the construction of new manufacturing facilities and the expansion of existing production capacity.

The San Jose, California plant, which began operating in March, is a modern, expandable snack food plant producing potato chips, corn chips, and other products. The 110,000 sq. ft. facility is located on a 12-acre site and provides snack food products to the entire San Francisco Bay Area.

In May, 1965 a new manufacturing plant began operations in Orlando, Florida. This 65,000 sq. ft. plant, with a special refrigerated potato storage area, serves the central and southern Florida areas.

Construction on a major manufacturing complex was begun in October in Dallas. The \$4 million facility will consist of a 132,000 sq. ft. snack food manufacturing plant and a 79,000 sq. ft. research and development building. It is scheduled for completion in the late fall of 1966.





Production capacity was increased at Frito-Lay plants in Chamblee, Ga., Louisville, Ky., Fall River, Mass., and Los Angeles, Cal. In addition, plants at Rhinelander and Madison, Wisconsin were expanded to replace and enhance the volumes of the Minneapolis plant which was shut down in September. The Houston plant is also being expanded in a project which began in December and will be completed by early summer 1966.

A new and unique potato storage warehouse was constructed during the year in Grand Forks, N. D. with a capacity of 10 million pounds of potatoes. The light weight steel, pre-fabricated, foam insulated building represents an innovation in design and construction of potato storage facilities.

Belle Products division added a new automated maraschino cherry production line in its Houston plant, which provides increased capacity and greater efficiency in processing cherries.

In the Nu-Way Foods division a realignment of production facilities resulted in greater efficiency and additional jelly and syrup packaging capacity.

Empire State Sugar Company—Empire State Sugar Company was established as an operating division of PepsiCo, Inc. in 1965. The facilities of the Sugar Division include a raw cane sugar refinery in New York City, which has been in operation since 1933, and a new combination beet/cane sugar plant in Central New York State. When completed, the New York State operation will be the first sugar plant capable of making both beet and cane sugars in the United States, and is expected to be the largest, automated sugar factory in the world.

Construction—Under an agreement for the construction of the new beet/cane sugar refinery, the contractor was required to deliver a complete and operable plant no later than September 30, 1965. Major portions of the construction schedule were met during 1965, although final completion has been seriously delayed and, therefore, full operations are not expected until October, 1966.

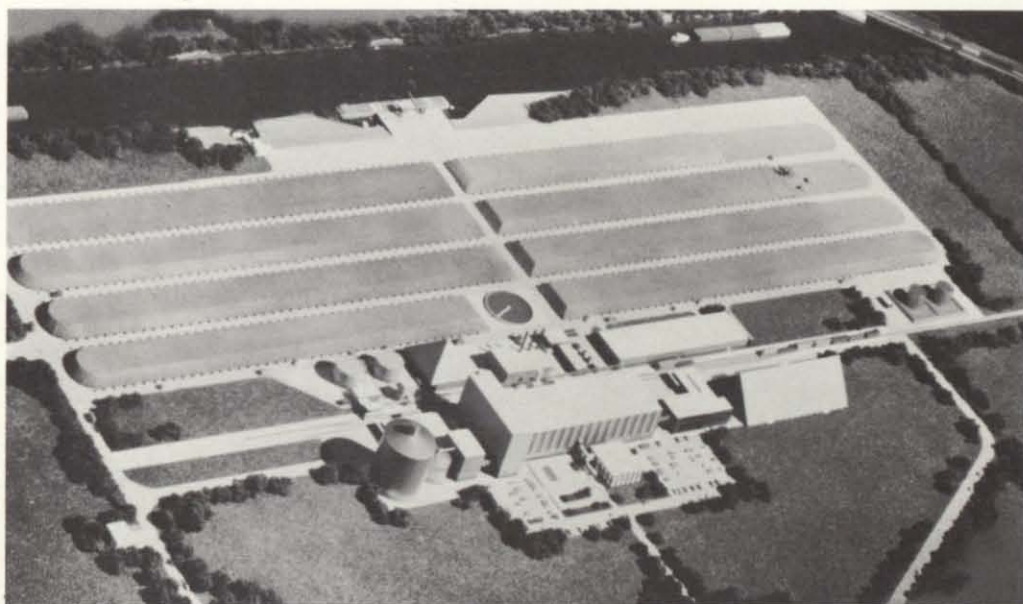
The contractor estimates that the cost of completion of the facility will substantially exceed the maximum guaranteed cost under the agreement. It is not possible at this time to determine what

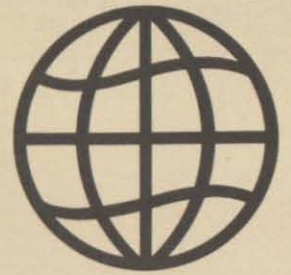
portion, if any, of such excess cost will be the obligation of the Company.

The delay has also inflated the plant's pre-production, start-up and initial production costs. The Company has reserved all its rights against the contractor.

Raw Cane Refinery—The Long Island City, N. Y. sugar refinery, which produces liquid sugars, has returned to full production after the settlement of the recent work stoppage.

The Future—The Company regards the new sugar plant project from the long-range point of view. It is expected that the plant will be fully completed and operating on a profitable basis within a reasonable period of time, and that this facility will efficiently produce high quality sugar for sale and distribution within a marketing area which has substantial growth potential.





Peter K. Warren, *President*





COLA

Twist-Off

Frito

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PepsiCo International Division

PepsiCo International is a new division established to conduct all of PepsiCo's food and beverage business outside the U. S. The most rapidly growing parts of the Company's operations are in the international sphere.

Planning for Growth—The benefits and opportunities of the union between Pepsi-Cola and Frito-Lay are evident in the international area. Through a strong Pepsi-Cola international organization, with twenty years' experience in consumer products marketing, Frito-Lay products are expected to be expanded into the world's markets in an effective and orderly manner as opportunities are found.

Preliminary planning and research is currently being carried on in the most promising foreign markets for the development of food operations. As a means of entry into these markets the Division plans to acquire existing businesses and develop joint ventures or new business opportunities, depending on the local market situation.

Where indicated by this research effort, the Division will establish additional snack or convenience food manufacturing facilities outside the U. S. Because of the nature of snack food products and special market conditions, it is essential that the manufacturing plants be close to the distribution system.

The proceeds from the debenture issue (described in the Shareholder Letter) will



be used to help finance the expansion of food products in foreign markets.

Organization—At the time of the creation of PepsiCo International, the organization was decentralized in order to have timely management decisions available at the scene of operations. The Division now operates through six profit centers managed by vice presidents reporting to the International headquarters in New York. These operating centers are Canada, Europe, Middle East, South Africa, Latin America and Far East.

An orientation meeting for the International management, dealing with the snack or convenience food business, was held in Dallas in October. Fifty executives from twenty foreign countries studied Frito-Lay's operations and participated in planning for the expansion of the Company's food products overseas.

Continued growth in the International Division should be supported by the following factors: [1] the potential for marketing snack foods overseas; [2] increased emphasis on soft drink flavors; and [3] a strengthened and more efficient field operating staff.

Overseas Food Operations—At year's end, the Company had wholly-owned subsidiaries in Great Britain (Crimpy Crisps) and Canada, and a partnership with H. Bahlens Keksfabrik K.G. and Heinz Flessner, in Germany. PepsiCo International also has a licensee in South Africa, Quix Products Ltd., which manufactures and sells FRITOS corn chips in South Africa, with headquarters in Johannesburg.

A first step in the expansion of snack food operations outside the U. S. was PepsiCo's acquisition in December of Selectos, S.A., a leading snack food producer in Mexico City. Plans for expanding this business in Mexico, through increased distribution, new products and improved facilities, are being made.

Soft Drink Products—Plans are under way to market the highly successful, domestic soft drink, MOUNTAIN DEW, outside the United





States. In some areas the product will be sold under the name RODEO since in many parts of the world the "western" theme has a greater identification and meaning than the "hillbilly" theme.

The year was also highlighted by an increasing emphasis on MIRINDA flavors, PASO DE LOS TOROS tonic water, and TEEM. MIRINDA's sales for the year were up substantially over the previous year, and its share of total soft drink sales overseas increased considerably.

Soft Drink Facilities—At the end of 1965, PepsiCo International had 455 bottling plants in 106 countries and territories, including company-owned plants. Twenty-eight new bottling plants outside the U. S. were opened throughout the world during the year. Fourteen of these plants were in Latin America; four in Europe; six in the Far East; and four in South Africa. In addition, marketing operations were begun in Bolivia and Guadeloupe.

New Frontier—During 1965 the Company successfully negotiated for the introduction of Pepsi-Cola in Yugoslavia and Rumania through local, franchised bottling operations. The move supports U. S. Government policy encouraging trade with Eastern bloc countries in non-essential items. The plant in Yugoslavia is scheduled to open in the late spring of 1966 and a plant in Rumania is expected to open in early 1967.





Lease Plan International Corp.

Lease Plan joined PepsiCo in January, 1966 and added a new dimension to the business. Leasing operations are oriented to "service" rather than "products," and the growth potential for this area is substantial.

The desirability of owning resources, which has been an important aspect in corporate and business philosophy over the years, is now being challenged by the concept of "use without ownership." Increasingly, individuals and corporations have turned to leasing as being more economical and convenient than ownership.

In the area of leasing automotive equipment, Lease Plan is an industry leader. The Company leases and finances the leasing of cars, trucks and other equipment in the United States and to some extent outside this country, with foreign affiliates in Canada, Puerto Rico, Holland and Japan.

Organization — H. L. Meckler, Lease Plan's president and chief executive officer, has built LPI into one of the major transportation leasing service companies in the world.

The business is operated through four principal divisions: Finance Lease, Truck Lease, Contract Carrier and Common Carrier.

Finance Leasing — The Finance Lease division engages in the leasing of cars and trucks in wholesale quantities to corporations with fleets in excess of 100 vehicles, and the retail leasing of

cars and trucks, for the most part to corporations with smaller fleets. Approximately 30,000 vehicles are leased by this division to large corporations with substantial fleets. LPI performs statistical services and analysis for these major clients in order to provide the most economical fleet operation obtainable. To further these economies LPI emphasizes reconditioning of used vehicles so that superior performance is achieved in sales of these vehicles on behalf of its clients.

The Company's retail finance lease organization consists of two California-based subsidiaries, Executive Car Leasing Company and VIP Car Leasing Company. Approximately 15,000 vehicles are leased to smaller concerns and individuals in California, the Southwest and Northeast U. S., and Puerto Rico.

As a new direction in the LPI retail leasing program, Executive Car Leasing System was formed in 1964 to lease cars to individuals and corporations with small fleets through a franchised dealer organization. Under "non-recourse" arrangements, local banks handle the financial aspects of the franchisees' leases, with recourse for any losses being solely between the bank and the leasing customer. This program has received an excellent response from both banks and car dealers. Executive Car Leasing System now has nearly 100 franchises in the Northeast and Central United States.

Truck Leasing — The Truck Leasing division specializes in leasing large fleets of trucks with maintenance and, in some instances, with drivers. Truck fleets under maintenance contracts are serviced on the customer's premises by Lease Plan. The Truck Leasing Division owns approximately 2,500 vehicles of various types, all of which are under lease.





New Headquarters—In July Lease Plan moved into a new international headquarters building in Great Neck, Long Island, N. Y. In November the Company consolidated its nationwide electronic data processing operations in Tulsa, Oklahoma.

Contract Carrier—The Contract Carrier division transports special commodities over irregular routes along the eastern seaboard on a scheduled basis for three customers. For this haulage service the division operates approximately 300 vehicles and maintenance shops on the premises of each customer.

Common Carrier—The Common Carrier division consists of an operating subsidiary, National Trailer Convoy Inc., which is based in Tulsa, Oklahoma. National Trailer is a hauler of mobile homes throughout the United States for manufacturers, distributors and individual owners. Approximately 800 tractors were employed in hauling operations during 1965.

A factor in the growth of this service has been the establishment of over 1,000 new trailer parks each year in the U. S. to accommodate annual sales of approximately 150,000 new mobile homes.

ARTHUR YOUNG & COMPANY

277 PARK AVENUE
NEW YORK, N.Y. 10017

The Board of Directors and Shareholders,
PepsiCo, Inc.

We have examined the accompanying consolidated balance sheet of PepsiCo, Inc. and consolidated subsidiaries at December 31, 1965 and the related consolidated statements of income, retained earnings and capital in excess of par value for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have received the reports of other independent public accountants with respect to their examinations of the financial statements of certain major operating units of the Company and consolidated subsidiaries, and we assume responsibility for their examination in the same manner as if made by us.

In our opinion, the statements mentioned above present fairly the consolidated financial position of PepsiCo, Inc. and consolidated subsidiaries at December 31, 1965 and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Arthur Young & Company

March 23, 1966

Consolidated Statement of Income *for the years ended December 31, 1965 and 1964*

PepsiCo, Inc. and Consolidated Subsidiaries

	1965	1964
Revenues		
Net sales	\$509,950,282	\$455,811,574
Interest and other income	2,193,036	2,068,832
	512,143,318	457,880,406
Costs and expenses		
Cost of sales	234,618,140	203,010,885
Advertising, selling and administrative	215,740,763	201,410,850
Interest expense	1,618,867	1,466,145
Other expenses	2,773,407	1,824,593
Adjustment for foreign activities	287,139	(819,756)
	455,038,316	406,892,717
	57,105,002	50,987,689
Provision for United States and foreign income taxes	26,540,000	24,599,801
	30,565,002	26,387,888
Equity in the net income of Lease Plan International Corp.	2,634,299	1,917,437
Net income	\$ 33,199,301	\$ 28,305,325

Depreciation and amortization included above: 1965—\$13,770,000; 1964—\$11,560,000.

Consolidated Balance Sheet *December 31, 1965 and 1964*

PepsiCo, Inc. and Consolidated Subsidiaries

Assets	1965	1964
Current assets		
Cash	\$ 15,810,268	\$ 21,936,345
Short-term securities (approximates market)	27,036,450	31,326,306
Notes and accounts receivable, less allowance	34,219,161	30,671,930
Inventories—at cost (principally average method) not in excess of market	44,468,622	30,583,329
Prepaid expenses	7,455,922	6,294,446
Total current assets	128,990,423	120,812,356
Investments and long-term receivables		
Lease Plan International Corp.—at equity	15,267,181	11,107,993
Receivables (non-current) and other investments (at cost less reserves)	11,223,214	8,479,307
	26,490,395	19,587,300
Property, plant and equipment, at cost		
Land	8,285,757	7,771,242
Buildings	34,002,635	28,204,388
Machinery and equipment	125,873,115	103,405,211
Bottles and cases	17,146,520	15,320,127
	185,308,027	154,700,968
Less accumulated depreciation and amortization	75,569,873	63,550,372
	109,738,154	91,150,596
Trademarks, formulas and goodwill (less amortization) and other assets	6,229,815	6,137,838
	\$271,448,787	\$237,688,090

Liabilities and Shareholders' Equity	1965	1964
Current liabilities		
Notes payable (including current installments on long-term debt)	\$ 12,199,417	\$ 6,451,790
Accounts payable and accrued liabilities	42,222,125	29,072,349
United States and foreign income taxes	12,237,958	16,136,168
Customers' deposits on bottles and cases	8,387,753	7,733,888
Total current liabilities	75,047,253	59,394,195
Long-term debt (less current installments)		
5¼ % notes payable, due \$1,250,000 annually to 1974	11,250,000	13,750,000
5½ % note payable, due \$380,000 annually through 1981	5,550,000	5,850,000
Other	1,030,590	1,221,847
	17,830,590	20,821,847
Other		
Deferred United States income taxes	5,958,563	5,011,995
Reserve for foreign activities	2,164,007	2,493,318
	8,122,570	7,505,313
Shareholders' equity		
Capital stock, par value 33⅓ ¢ per share; authorized 12,000,000 shares; issued and outstanding at December 31, 1965, 10,330,990 shares	3,443,663	3,412,437
Capital in excess of par value	32,422,251	30,199,701
Retained earnings	134,582,460	116,354,597
Total shareholders' equity	170,448,374	149,966,735
	\$271,448,787	\$237,688,090

Consolidated Statement of Retained Earnings

	1965	1964
Balance at beginning of year		
PepsiCo, Inc.	\$116,354,597	\$ 72,517,507
Pooled companies (including in 1965 adjustment for different fiscal year)	2,952,175	28,068,584
	119,306,772	100,586,091
Net income for the year	33,199,301	28,305,325
Cash dividends		
PepsiCo, Inc. (1965—\$1.60; 1964—\$1.40)	(14,243,519)	(9,235,697)
Pooled companies prior to merger	(3,364,140)	(3,429,905)
Other	(315,954)	128,783
Balance at end of year	\$134,582,460	\$116,354,597

Capital in Excess of Par Value

Balance at beginning of year	\$ 30,199,701	\$ 12,275,894
Adjustment for poolings (less expenses: 1965—\$759,822)	(547,535)	15,643,473
Excess of proceeds over par value of shares issued under stock option plans (including pooled companies prior to merger) and conversion of Lease Plan debentures	2,720,525	2,277,732
Other	49,560	2,602
Balance at end of year	\$ 32,422,251	\$ 30,199,701

Notes to Consolidated Financial Statements

PepsiCo, Inc. and Consolidated Subsidiaries

Note 1—Principles of consolidation The Company acquired the business and assets of Frito-Lay, Inc. in June 1965 and of Lease Plan International Corp. in January 1966, in exchange for a total of 3,609,371 shares of its capital stock and the assumption of substantially all of the liabilities of these two companies. These transactions have been treated as poolings of interests and are included in the accompanying financial statements on the following basis: (1) the accounts of Frito-Lay are included for calendar year 1965 and for its fiscal year 1964 which ended August 29, 1964, the difference between such fiscal year 1964 and calendar year 1964 being not material in relation to consolidated net income and (2) the accounts of Lease Plan are not consolidated and separate financial statements are included in this Annual Report; however, the Company's equity in Lease Plan's net assets and net income as of and for the years ended December 31, 1965 and 1964 are included for these years. As part of the pooling with Lease Plan, the Company contributed its wholly-owned non-consolidated subsidiaries, Pepsi-Cola Equipment Corp. and Margdave Realty Corporation to the new Lease Plan subsidiary.

The accounts of all other active subsidiaries are included in the accompanying consolidated financial statements except for certain insignificant overseas subsidiaries which are carried principally at the Company's equity in these net assets. With respect to one of the Company's consolidated domestic subsidiaries, a net provision of \$260,000 has been included in "Other expenses" for estimated costs and pre-production and start-up expenses of the Montezuma, New York sugar refinery, after reduction for applicable federal income tax benefit of \$1,348,000 and for investment credit of \$1,200,000.

Foreign currency items have been translated at appropriate rates of exchange. The total assets, total liabilities and net current liabilities of consolidated foreign subsidiaries and branches (other than Canadian subsidiaries) stated in terms of United States dollars were \$52,800,000, \$23,900,000 and \$600,000 respectively, at December 31, 1965.

Note 2—Reserve for foreign activities It is the policy of the Company to exclude from consolidated net income and consolidated retained earnings the unremitted earnings of foreign subsidiaries, other than Canadian subsidiaries, by providing a Reserve for Foreign Activities by charges against income (Adjustment for Foreign Activities). The Reserve is used to absorb extraordinary losses that arise from foreign operations such as the losses resulting from devaluation of foreign currencies and unsettled political conditions preventing normal commercial operations.

Note 3—Retained earnings—restrictions The amended loan agreement of the Company under its 5¼% notes payable contains various restrictions, including provisions relating to restrictions on the payment of dividends and the purchase of shares of the Company's capital stock. Of the consolidated retained earnings at December 31, 1965, \$68,000,000 was free of such restrictions.

Note 4—Stock options At December 31, 1965, 451,609 shares of the Company's capital stock were reserved for issuance, of which 433,667 shares were reserved under restricted or qualified stock option plans of the Company and pooled companies and 17,942 shares were reserved for the conversion (at \$20.90 per share) of the \$375,000 principal amount of 6% convertible subordinated debentures of Lease Plan.

Of the shares reserved for issuance under stock option plans, 334,060 shares were for plans of the Company adopted in 1959 and

1964; 78,042 shares for options granted under the Frito-Lay Plan; and 21,565 shares for options granted under a plan of Lease Plan. In connection with the poolings described in Note 1, the obligations under the latter two plans were assumed by the Company, including 130,866 outstanding options at the respective acquisition dates. At December 31, 1965, options were outstanding on 348,267 shares (of which 118,268 were then exercisable) having an aggregate option price of \$17,853,700; the balance of 85,400 shares being available for future grants under the Company's 1964 Plan. Changes in options during 1965 were as follows: granted as to 30,850 shares having an aggregate option price of \$2,345,772; exercised as to 61,839 shares having an aggregate option price of \$2,549,486; and cancelled as to 335 shares.

Note 5—Long-term leases and commitments The Company and its consolidated subsidiaries are lessees under long-term leases, expiring at various dates to 1992 having minimum aggregate annual rentals of \$4,900,000 (exclusive of insurance, taxes and repairs). Included in this amount is an annual rental of approximately \$1,290,000 under a Lease Agreement with a wholly-owned subsidiary of Lease Plan for a period of 30 years, covering the sugar refinery in Montezuma, New York owned by the latter. The latter is obligated under mortgage notes payable of \$21,111,842 which the annual rental is intended to amortize as to principal and interest. If additional funds are expended in settlement of a dispute with the construction contractor (for additional information see Page 24 of the Annual Report and Note 3 to Lease Plan financial statements) the Company would incur additional annual charges, estimated to be not material in amount, for the use of the property. Pending negotiations, arbitration or other proceedings, the parties have agreed, while reserving all rights, each to advance 50 per cent of the cost of completion of this facility to an amount of approximately \$2,250,000 each.

At December 31, 1965 the Company and its consolidated subsidiaries were contingently liable as guarantors of loans, principally to franchised bottlers, aggregating \$5,000,000. In addition the Company has guaranteed loans of \$10,750,000 incurred by Pepsi-Cola Equipment Corp., a subsidiary of Lease Plan, and has other guarantees of \$500,000.

The Company is also contingently liable for the repurchase of vending equipment acquired by franchisees, unpaid balances by them to banks in this regard being \$15,000,000 at December 31, 1965.

Note 6—Federal Trade Commission In 1963 the Federal Trade Commission issued a complaint against Frito-Lay alleging violations of Section 7 of the Clayton Act, as amended, by reason of the acquisition of certain companies during the years 1958, 1960 and 1961. The complaint seeks to require divestiture of the assets or stock of such companies (which constitute a substantial portion of Frito-Lay's consolidated assets and operations) as going concerns and to prohibit for a period of ten years the acquisition of companies engaged in the manufacture or sale of potato chips, corn chips or pretzels. In the opinion of counsel, these charges are without legal basis. There were no significant developments in these proceedings during 1965. Proceedings remain in abeyance pending a decision by the United States District Court for the Eastern District of Texas as to the FTC's jurisdiction and other issues.

Note 7—Subsequent events In March 1966, PepsiCo Overseas Corporation, a wholly-owned subsidiary of the Company, issued outside the United States \$30,000,000 of 4½% guaranteed debentures, due in 1981. These debentures, which are guaranteed as to principal and interest by the Company, are convertible after September 1, 1967 into 322,581 shares of capital stock of the Company at a price of \$93 per share, subject to adjustment under certain conditions.

HASKINS & SELLS

CERTIFIED PUBLIC ACCOUNTANTS

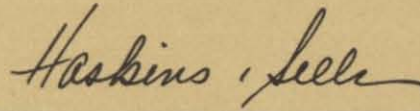
TWO BROADWAY
NEW YORK 10004

Lease Plan International Corp.:

We have examined the consolidated balance sheet of Lease Plan International Corp. and subsidiaries as of December 31, 1965 and the related consolidated statements of income, retained earnings, and capital surplus for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated balance sheet and consolidated statements of income, retained earnings, and capital surplus present fairly the financial position of the companies at December 31, 1965 and the results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

March 21, 1966



Consolidated Statement of Income for the Years Ended December 31, 1965 and 1964

Lease Plan International Corp. and Subsidiaries

	1965	1964
Operating Revenues:		
Finance leasing	\$42,830,932	\$35,902,894
Common carrier	12,847,404	11,088,494
Truck leasing and contract carrier	9,658,755	9,902,508
Other	739,506	788,328
Total Operating Revenues	66,076,597	57,682,224
Operating Expenses:		
Direct operating costs (other than purchased transportation)	10,288,040	10,607,066
Purchased transportation	6,784,322	6,187,855
Depreciation	33,421,283	28,073,188
Interest	5,455,878	4,483,179
Total Operating Expenses	55,949,523	49,351,288
Gross income	10,127,074	8,330,936
Administrative and General Expenses	6,420,875	4,871,499
Income Before Federal Income Taxes	3,706,199	3,459,437
Federal Income Taxes (Note 4):		
Current	500,000	260,000
Deferred	571,900	1,282,000
Net Income	\$ 2,634,299	\$ 1,917,437

Consolidated Statements of Retained Earnings and Capital Surplus for the Year Ended December 31, 1965

Lease Plan International Corp. and Subsidiaries

Consolidated Retained Earnings:

Balance, January 1, 1965	\$5,281,022
Add (Deduct):	
Adjustment of prior years' deferred Federal income taxes (Note 4)	(165,000)
Total	5,116,022
Net income	2,634,299
Cash dividends declared	(585,246)
Balance, December 31, 1965	\$7,165,075

Consolidated Capital Surplus:

Balance, January 1, 1965	\$4,264,907
Add (Deduct):	
Par value of PepsiCo, Inc. Capital Stock received for issuance in connection with the acquisition of Lease Plan	\$ 221,964
Excess of par value of common stock of the former Lease Plan International Corp. over par value of the PepsiCo, Inc. Capital Stock issued therefor (Note 1)	\$1,242,999
Less—par value of shares of the former Lease Plan International Corp. issued in 1965 (Note 1) (see below)	3,899
	1,239,100
Contribution by PepsiCo, Inc. of its investment in Pepsi-Cola Equipment Corporation (Note 1)	100,000
Balance January 1, 1965 as adjusted	5,825,971
Par value of shares of common stock of the former Lease Plan International Corp. issued in connection with the stock option plan and the conversion of subordinated debentures in 1965, which were converted into shares of PepsiCo, Inc. Capital Stock in connection with the pooling of interests (Note 1) (see above)	3,899
Contribution by PepsiCo, Inc. of its investment in Margdave Realty Corporation (Note 1)	778,653
Excess of proceeds over par value of 3,373 shares of common stock of the former Lease Plan International Corp. issued under stock option plan (Note 5)	99,421
Excess of conversion price over par value of 526 shares of common stock of the former Lease Plan International Corp. issued upon conversion of subordinated debentures (Note 3)	4,464
Estimated expenses incidental to pooling of interests with PepsiCo, Inc. (Note 1)	(105,000)
Balance, December 31, 1965	\$6,607,408

Consolidated Balance Sheet *December 31, 1965 and 1964*

Lease Plan International Corp. and Subsidiaries

Assets	1965	1964
Current Assets:		
Cash	\$ 4,448,567	\$ 2,940,609
Receivables (less allowances for doubtful accounts—1965, \$250,895; 1964, \$240,753)	7,255,064	5,113,977
Inventories, at cost	469,507	255,049
Prepaid expenses, etc.	864,525	887,216
Total current assets	13,037,663	9,196,851
Investments and Advances:		
Investment in and advances to non-controlled companies at cost	342,463	308,910
Investment in Pepsi-Cola Equipment Corp. (Note 1)		100,000
Total investments and advances	342,463	408,910
Property and Equipment, at Cost:		
Land and buildings	1,267,590	1,620,734
Revenue property and equipment (Notes 2 and 3)	202,718,467	152,104,713
Service equipment, etc.	768,220	868,445
Total	204,754,277	154,593,892
Less accumulated depreciation	58,963,750	50,985,107
Net property and equipment	145,790,527	103,608,785
Franchises and Certificates	1,012,388	1,015,862
Other Assets	2,988,802	2,019,524
Intangible Assets Arising from Acquisitions Less Amortization	3,233,977	3,305,977
Total	\$166,405,820	\$119,555,909

Liabilities and Shareholders' Equity	1965	1964
Current Liabilities:		
Notes payable	\$ 156,380	\$ 65,103
Accounts payable	2,971,797	2,817,724
Accrued liabilities	1,830,542	1,204,658
6% senior notes (current portion)	180,000	180,000
4 $\frac{7}{8}$ % notes (current portion)	1,290,917	
Federal income taxes	433,379	
Total current liabilities exclusive of equipment obligations due within one year	6,863,015	4,267,485
Equipment Obligations Due Within One Year (Note 2)	37,683,711	31,928,309
Customers' Deposits and Rental Prepayments	1,376,638	1,396,566
Long Term Debt:		
Equipment obligations due after one year (Note 2)	77,119,389	63,798,354
6% senior notes due March 31, 1975 (less current portion) (Note 3)	1,640,000	1,820,000
4 $\frac{7}{8}$ % notes due March 1, 1996 (less current portion) (Note 3)	19,820,925	
6% convertible subordinated debentures due October 31, 1970 (Note 3)	375,000	380,000
Other notes payable	1,078,186	657,202
Total long term debt	100,033,500	66,655,556
Deferred Federal Income Taxes (Note 4)	5,181,775	4,200,000
Due to Parent Company	1,493,698	
Shareholders' Equity (Note 1):		
Common stock—authorized, issued and outstanding, 1,000 shares of \$1 par value	1,000	1,000
Capital surplus	6,607,408	5,825,971
Retained earnings	7,165,075	5,281,022
Total shareholders' equity	13,773,483	11,107,993
Total	\$166,405,820	\$119,555,909

See accompanying notes.

Notes to Consolidated Financial Statements

Lease Plan International Corp. and Subsidiaries

1. Basis of Consolidation The consolidated financial statements include the accounts of Lease Plan International Corp. and all subsidiaries in which Lease Plan has more than a 50 percent interest; companies in which Lease Plan's interest is 50 percent or less are included as investments.

On January 5, 1966, Eugenia Properties, Inc., a wholly-owned subsidiary of PepsiCo, Inc., acquired substantially all the assets and business of Lease Plan International Corp. in a transaction accounted for as a pooling of interests and then changed its name to Lease Plan International Corp. As a part of the pooling transaction, PepsiCo, Inc. on December 29, 1965, contributed its investments in wholly-owned subsidiaries, Pepsi-Cola Equipment Corp. and Margdave Realty Corporation, to Eugenia Properties, Inc. (now Lease Plan). The accompanying financial statements reflect the financial position and results of operations after giving retroactive effect to such pooling. The operations of Pepsi-Cola Equipment Corp. were included in consolidation with Lease Plan from January 1, 1965; operations prior thereto were nominal. The operations of Margdave Realty Corporation were included from its inception, November 4, 1965.

Operating revenues and related net income arising from transactions with PepsiCo, Inc. (Parent Company) amounting to \$2,788,750 and \$67,300, respectively, are included in the accompanying consolidated statement of income for the year ended December 31, 1965.

2. Equipment Obligations The maturities of equipment obligations outstanding at December 31, 1965 are approximately as follows: 1966—\$37,683,700; 1967—\$33,542,600; 1968—\$24,185,000; 1969—\$7,998,500; 1970—\$4,580,500; after 1970—\$6,812,800.

The equipment obligations are collateralized (except for those of one subsidiary) by the pledge of substantially all of the revenue equipment and by the assignment of substantially all of the revenues to be received under the various leases and contracts with customers. With respect to the one subsidiary PepsiCo, Inc. has guaranteed \$10,750,000 of equipment obligations not collateralized by the pledge of revenue equipment.

3. Long Term Debt The 6% convertible subordinated debentures due October 31, 1970 which were convertible into shares of Lease Plan common stock prior to January 5, 1966 (see Note 1), are convertible at any time prior to maturity into shares of PepsiCo Capital Stock at \$20.90 per share (subject to further adjustment in the event of certain changes in the issued Capital Stock of PepsiCo). The debentures are redeemable at the option of Lease Plan in whole or in part at par.

Under the terms of the note agreement for the 6% senior notes, dividends (other than stock dividends) may not be paid by Lease Plan and capital stock of Lease Plan may not be purchased, redeemed or retired unless retained earnings exceed a calculated amount. Consolidated retained earnings free of such restriction at December 31, 1965 amounted to approximately \$4,643,300.

The 4 $\frac{7}{8}$ % notes due March 1, 1996 are collateralized by a mortgage on the revenue property acquired with the proceeds of the notes. Such property was leased to a subsidiary of PepsiCo, Inc. for a term of thirty years at an annual rental equal to the annual payment for principal and interest on the notes plus the costs of maintaining the property. Performance by the subsidiary under the terms of the lease has been guaranteed by PepsiCo, Inc. The contractor for the construction of this property has made public disclosure that the cost of completion of such construction will exceed the guaranteed maximum cost established under an agreement with PepsiCo by approximately \$6,878,000 and has stated that it proposes to submit claims to PepsiCo for increases in said guaranteed maximum amount. It is anticipated that unless the matter is settled by negotiation there will be arbitration or other proceedings to determine what, if any, portion of such contractor claims is the obligation of PepsiCo and PepsiCo has reserved all of its rights to make claims against the contractor for damages in presently indeterminate amounts.

4. Deferred Federal Income Taxes For Federal income tax purposes an accelerated method of computing depreciation has been used for certain depreciable assets, and accordingly there has been an excess of depreciation as computed for tax purposes over the depreciation provided on the straight-line method in the consolidated financial statements. This excess has resulted in tax deferrals which have been charged against income and credited to deferred Federal income taxes.

Prior to the merger (see Note 1) Lease Plan provided deferred Federal income taxes on an individual company basis. Since the effective rates on an individual company basis were lower than the effective rates on a consolidated basis and since it is expected that PepsiCo, Inc. will file future income tax returns on a consolidated basis, including Lease Plan and its subsidiaries, additional deferred Federal income taxes of \$165,000, applicable to years prior to 1965 were provided out of retained earnings. For comparative purposes, the amount applicable to the year 1964, \$22,000, was reflected in the accompanying 1964 consolidated statement of income. The provision for 1965 Federal income taxes reflected in the consolidated statement of income was made on the consolidated basis.

The Revenue Act of 1962 allows an investment credit against Federal income taxes payable of up to 7% of the cost of qualified depreciable property acquired after 1961, and the Act also permits a lessor to pass on to a lessee the credit with respect to such property. The credit not so passed on by Lease Plan in the amount of \$669,800 for 1965, was used to reduce the provision for Federal income taxes in the consolidated statement of income with related reductions in the consolidated balance sheet of \$554,800 in the amount due to parent company and \$125,000 in Federal income taxes payable.

5. Stock Options On January 5, 1966 (see Note 1) outstanding options granted for the purchase of Lease Plan common stock under its stock option plans were converted into options to purchase shares of Capital Stock of PepsiCo, Inc. at the conversion rate applicable to the outstanding common stock of Lease Plan. Accordingly, options outstanding at December 31, 1965 for the purchase of 47,442 shares of Lease Plan common stock were converted into options to purchase 21,565 shares of PepsiCo, Inc. Capital Stock.

PepsiCo, Inc.**Executive Offices**

500 Park Avenue, New York, N.Y. 10022

Officers

Donald M. Kendall—*President and Chief Executive Officer*

Herman W. Lay—*Chairman of the Board*

Thomas Elmezzzi—*Executive Vice President*

Fladger F. Tannery—*Executive Vice President*

John R. Allison—*Vice President, Controller*

Peter J. DeLuca—*Vice President, General Counsel, Secretary*

Paul W. Kayser—*Vice President, Director of Industrial Relations*

H. L. Meckler—*Vice President*

Herman A. Schaefer—*Vice President, Finance*

George Williamson—*Vice President, Treasurer*

Edson E. Beckwith—*Assistant Treasurer*

W. Lamar Lovvorn—*Assistant Secretary*

James W. Robertson—*Assistant Secretary*

Harold E. Rome—*Assistant Secretary*

Pepsi-Cola Division**Executive Offices**

500 Park Avenue, New York, N.Y. 10022

James B. Somerall, *President*

Frito-Lay Division**Executive Offices**

Frito-Lay Tower, Exchange Park, Dallas, Texas 75235

William B. Oliver, *President*

PepsiCo International Division**Executive Offices**

500 Park Avenue, New York, N.Y. 10022

Peter K. Warren, *President*

Lease Plan International**Executive Offices**

130 Steamboat Road, Great Neck, N.Y. 11022

H. L. Meckler, *President*

Annual Meeting

The Annual Meeting of our Stockholders

will be held at the Company's home office

at 100 West Tenth Street in Wilmington,

Delaware, at 2:00 P.M. (E.D.T.)

Wednesday, May 4, 1966

Transfer Agents

Marine Midland Grace Trust Company of New York, New York, N.Y.

The First National Bank of Jersey City, Jersey City, N. J.

Harris Trust and Savings Bank, Chicago, Illinois

First National Bank in Dallas, Dallas, Texas

The Fulton National Bank of Atlanta, Atlanta, Ga.

Registrars

The Chase Manhattan Bank, New York, N.Y.

The First National Bank of Chicago, Chicago, Ill.

Republic National Bank of Dallas, Dallas, Texas

The First National Bank of Atlanta, Atlanta, Ga.

Auditors

Arthur Young & Company, New York, N.Y.

